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No. 95

In the Supreme Court of the United States

OCTOBER TERM, 1932

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

COMMONWEALTH IMPROVEMENT COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONER

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 11–14) is reported in 20 B. T. A. 1189. The opinion of the Circuit Court of Appeals for the Third Circuit (R. 29–33) is reported in 57 F. (2d) 47.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 17, 1932. (R. 33.) The petition for certiorari was filed May 20, 1932, and was

granted May 31, 1932. Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether a corporation may derive taxable income upon an exchange of securities with its sole stockholder if, as between other parties, income would be derived.

2. Where a stockholder exercises the right to subscribe to new stock of substantially the same character as the stock with respect to which the right is issued, should the average cost of the old and new shares be used as the basis for determining gain or loss upon the sale or other disposition of the original shares, as provided by Article 39 of Treasury Regulations 45 as amended?

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060.

> SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and
>
> (2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203.

(b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; * * *.

Article 39 of Treasury Regulations 45 (1920 Edition), as amended by Treasury Decision 3402, I–2 C. B. 63, promulgated October 18, 1922:

ART. 39. *Sale of stock and rights.*—* * * Where a corporation issues to its stockholders the right to subscribe to its stock, the value of the right does not constitute taxable income to the stockholder, but gain may be derived or loss sustained by the stockholder from the sale of such right. * * *:

* * * Where the stockholder exercises his right to subscribe to new stock of substantially the same character or preference as the stock with respect to which the right is issued, the cost of the old and new shares (or, if acquired prior to March 1, 1913, the fair market value as of that date) will be the quotient of the cost of the old shares, plus the subscription price of the new shares, divided by the total number of the old and new shares. * * *

STATEMENT

The Circuit Court of Appeals for the Third Circuit (R. 33) reversed a decision of the Board of Tax Appeals determining a deficiency of $294,388.42 for the year 1920 (R. 14) upon the following facts:

In 1912, P. A. B. Widener, a resident of Pennsylvania, transferred all his securities, except those of Pennsylvania corporations and one share of United States Steel Corporation stock, to the respondent, a Pennsylvania corporation, in return for all of respondent's stocks and bonds, aggregating $25,000,000 par value. (R. 9.[1])

Widener died testate in 1915. (R. 10.) Thereafter, respondent's officers and three directors were Widener's two executors and trustees,[2] and the attorney for his estate. The trustees received salaries as officers of the taxpayer, but no commissions as trustees. The office expenses of the estate were paid by the respondent. (R. 10.)

Among the securities transferred by Widener to the respondent in 1912 were 225,000 shares of British-American Tobacco Company stock, the value of which on March 1, 1913, was $5,315,625, or $23.625 per share. (R. 11.)

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[1] At the time of this transaction it was supposed that corporate stocks and bonds of a decedent were subject to estate taxes of the State of the decedent's domicile as well as the State of the domicile of the corporation. See *Blackstone* v. *Miller*, 188 U. S. 189, overruled January 6, 1930, in *Farmers Loan Co.* v. *Minnesota*, 280 U. S. 204. Cf. *Baldwin* v. *Missouri*, 281 U. S. 586; *First National Bank* v. *Maine*, 284 U. S. 312.

While the sole witness for respondent denied that this transfer was made for the purpose of avoiding such double taxation in event of Widener's death (R. 25), the record strongly indicates that such was its purpose (R. 9–10, 20, 30), and this witness thought that the plan had resulted in this saving (R. 25).

[2] Widener's son and a grandson. (R. 10.)

In 1919 the respondent acquired the right to subscribe for one new share of this stock for every three shares it held, at a price of $4.3525 per share, and exercised such right by purchasing 75,000 shares for $326,437.50. (R. 3, 11.)

In 1920 respondent transferred to the Widener Estate, the certificates representing the original 225,000 shares of this stock of a then market value of $23.50 a share, or a total of $5,287,500, in return for which it received certain stocks and bonds and credits to its account of equal value. (R. 2, 11, 22–24.)

In its return for 1920 the respondent claimed a deduction for a loss computed by applying the selling price of $5,287,500 against $5,315,625, the March 1, 1913, value of the 225,000 shares. (R. 5, 12.)

The Commissioner of Internal Revenue disallowed the loss, and in accordance with Article 39 of Treasury Regulations 45, as amended by T. D. 3402, determined a gain by adding the March 1, 1913, value of the 225,000 shares ($5,315,625) to the cost of the 75,000 additional shares ($326,437.50) and dividing the total ($5,642,062.50) by the total number of shares (300,000). This gave an average cost base of $18.806875 per share, or a cost base of $4,231,546.88 for the 225,000 shares, which was $1,055,953.12 less than the value of the stocks, bonds, and credits received in exchange. Upon this difference the Commissioner determined a deficiency in tax of $294,388.42. (R. 5–7, 12, 14.)

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Upon petition for review the Board of Tax Appeals sustained the action of the Commissioner. (R. 14.) The Circuit Court of Appeals for the Third Circuit reversed, holding that since the estate owned all of the stock of the respondent the profit determined by the Commissioner was illusory and nonexistent. (R. 29–33.) Reaching that conclusion it became unnecessary for the court to determine the validity of Article 39, as amended, of Treasury Regulations 45, which is embraced in the second question stated, *infra*. This Court granted certiorari.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In deciding that the taxpayer, a corporation, and the Widener estate, which owned all the stock of the corporation, were in substance identical, so that a transaction between them could not result in gain or loss under Section 202 of the Revenue Act of 1918.

2. In not deciding that there was a deficiency in the amount of $294,388.42 in respondent's income and profits taxes for the year 1920.

3. In reversing the judgment of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

A corporation and its stockholders are separate entities; and it is of no importance that all of the corporate stock is held by a single person. Con-

gress has observed this distinction in each of the Revenue Acts enacted under the Sixteenth Amendment by taxing corporations and individuals separately and including dividends in the gross income of both. When Congress desired to have the distinction between a corporation and its sole stockholder disregarded, it made specific provision therefor by authorizing the filing of a consolidated return. The decision of the court below is contrary to decisions of this Court and the weight of authority in the other Federal courts.

The decisions of this Court in *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, and *Gulf Oil Corporation* v. *Lewellyn,* 248 U. S. 71, are distinguishable and do not control decision here.

If this Court reverses the decision of the court below, the computation of the tax as made by the Commissioner and approved by the Board of Tax Appeals should be affirmed.

ARGUMENT

I

THE RESPONDENT AND ITS SOLE STOCKHOLDER WERE SEPARATE TAXABLE ENTITIES, AND THEREFORE THE TRANSACTION INVOLVED RESULTED IN TAXABLE GAIN

The court below held that since the Widener estate "owned and controlled" the respondent (R. 32) the transfer of the assets of the corporation to the estate in exchange for its bonds and other property did not result in any taxable profit (R.

33). It considered that it was required to examine the substance of the transaction, and that when so considered the result of the exchange was a mere paper profit which it regarded as "illusory and nonexistent." (R. 33.)

In its brief in opposition the respondent urged that it was not necessary to disregard the separate corporate entity of respondent in order to reach the conclusion that the gain taxed was illusory and that the decision of the court below was based upon the peculiar facts of this case. If the same transaction had occurred between respondent and an individual or a corporation which did not own respondent's stock any resulting gain would have been clearly taxable. The contention that such gains are not taxable requires that the respondent and its sole stockholder be considered as one and the same person, having, in transactions *inter sese,* no separate identity in the eyes of the law.

The fundamental question presented is whether, if a transaction would otherwise result in taxable gain under the Revenue Acts, such gain must be disregarded where the transaction is between a corporation and its sole stockholder.

It is settled by many decisions of this Court that a corporation and its stockholders are separate entities. *Klein* v. *Board of Tax Supervisors,* 282 U. S. 19, 23–24; *Cannon Manufacturing Co.* v. *Cudahy Packing Co.,* 267 U. S. 333; *People's Tobacco Co.* v. *American Tobacco Co.,* 246 U. S. 79;

Donnell v. *Herring-Hall-Marvin Safe Co.*, 208 U. S. 267, 273; *Peterson* v. *Chicago, Rock Island & Pacific Ry.*, 205 U. S. 364, 392. In the *Klein* case, *supra*, this Court said (at p. 24):

> But it leads nowhere to call a corporation a fiction. If it is a fiction it is a fiction created by law with intent that it should be acted on as if true. The corporation is a person and its ownership is a nonconductor that makes it impossible to attribute an interest in its property to its members. *Donnell* v. *Herring-Hall-Marvin Safe Co.*, 208 U. S. 267, 273. * * *

In the *Donnell* case, *supra*, this Court said (at p. 273):

> Philosophy may have gained by the attempts in recent years to look through the fiction to the fact and to generalize corporations, partnerships and other groups into a single conception. But to generalize is to omit, and in this instance to omit one characteristic of the complete corporation, as called into being under modern statutes, that is most important in business and law. A leading purpose of such statutes and of those who act under them is to interpose a nonconductor, through which in matters of contract it is impossible to see the men behind. * * *

The fact that all of the corporate stock is owned by a single stockholder does not change the rule. *Planters' Cotton Oil Co.* v. *Hopkins*, 286 U. S. 332;

Cannon Manufacturing Co. v. *Cudahy Packing Co., supra,* 267 U. S. 333, 335, 337; *Conley* v. *Mathieson Alkali Works,* 190 U. S. 406, 408, 411–412; *American Cyanamid Co.* v. *Wilson & Toomer Fertilizer Co.,* 51 F. (2d) 665, 670 (C. C. A. 5th); *Texas Co. of Mexico, S. A.* v. *Roos,* 43 F. (2d) 1, 15 (C. C. A. 5th), certiorari denied, 282 U. S. 902; *Wagner* v. *Lucas,* 38 F. (2d) 391, 392 (App. D. C.); *Goldberg* v. *Commissioner,* 36 F. (2d) 551, 552 (App. D. C.).

It seems unnecessary to discuss the cases where the separate character of the corporate entity is relied on to cloak a fraud, or protect individuals from punishment for a violation of law, or to impede justice in some other way. In such cases, upon grounds of policy the separate entity is treated as a mere disguise which can not serve to protect the guilty. Such cases are necessary exceptions to the rule that the separate entity authorized by law is to be respected. It is obvious that the general rule and not the exception must govern a case where individuals have seen fit to obtain the advantages of transacting business through the corporate form and only seek to have the distinction between the corporation and its stockholders disregarded when a tax or other obligation can be avoided by doing so.

Congress has always recognized the distinction between a corporation and its stockholders in the Revenue Acts. Beginning with the Tariff Act of October 3, 1913, individuals and corporations have

been taxed separately[3] and dividends have been included in gross income both of individuals and corporations.

The only instance where Congress has provided for a qualified recognition for tax purposes of the community between controlling stockholder and corporation is in some of the provisions for consolidated returns. Beginning with the administration of the war income and excess-profits tax provisions of the Revenue Act of October 3, 1917 (c. 63, 40 Stat. 300), it was found that in order to avoid the excess-profits taxes imposed by that Act upon income falling within the higher brackets many corporations were creating subsidiaries and artificially apportioning thereto a part of their net profits. See *Pelican Ice Co.* v. *Commissioner,* 37 F. (2d) 285, 286 (C. C. A. 5th). To correct this situation and avoid the effect of the division of the income of a single enterprise among several taxable entities, Articles 77 and 78 of Treasury Regulations 41 were promulgated, requiring, among

[3] Subsections (A)(1), (B) and (G) of Section II, Tariff Act of October 3, 1913 (c. 16, 38 Stat. 114, 116); Sections 1, 2, and 10, Revenue Act of 1916 (c. 463, 39 Stat. 756, 757, 765); Sections 1, 4, and 201, Revenue Act of October 3, 1917 (c. 63, 40 Stat. 300, 302, 303); Sections 210, 213, and 230, Revenue Acts of 1918 (c. 18, 40 Stat. 1062, 1065, 1075), 1921 (c. 136, 42 Stat. 233, 237, 252), 1924 (c. 234, 43 Stat. 253; U. S. C., Title 26, Secs. 951, 954, and 981), and 1926 (c. 27, 44 Stat. 9; U. S. C. Sup. V, Title 26, Secs. 951, 954, and 981), and Sections 11, 13, and 22 of the Revenue Acts of 1928 (c. 852, 45 Stat. 791; U. S. C. Sup. V, Title 26, Secs. 2011, 2013, and 2022) and 1932.

other things, that corporations owned by a single stockholder or by the same interests should file a consolidated return. The underlying purpose of Articles 77 and 78 was carried forward and incorporated in modified form in Section 240 of the Revenue Acts of 1918, 1921, 1924, and 1926, and in Section 141 of the Revenue Acts of 1928 and 1932.

This legislation was designed to authorize the Commissioner to disregard the distinction between corporations and corporate stockholders where all were engaged in a single business enterprise. See *Handy & Harman* v. *Burnet,* 284 U. S. 136. That Congress was of the view that the Commissioner would not otherwise have had the power to so disregard the distinction between a corporation and its stockholders may be inferred from the fact that it deemed it necessary to extend such authority specifically by enacting the above legislation and to sanction retroactively Articles 77 and 78 of Treasury Regulations 41, *supra.*[4]

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[4] When H. R. 8245, which later became the Revenue Act of 1921, first passed the House of Representatives, section 1007 related to the validation of articles 77 and 78, *supra.* Concerning the purpose of this section the Committee on Ways and Means, in reporting the bill to the House, said (H. R. 350, 67th Cong., 1st Sess., p. 16):

"Section 1007: For the year 1917 affiliated corporations were permitted or required to make consolidated returns for the purpose of the excess-profits tax. *Owing to the equivocal language employed in the act of October 3, 1917, some doubt exists concerning the legality of this procedure. In order to set all doubts at rest, section 1007 validates the practice of the Treasury Department* under the revenue act

Thus, in all of the Revenue Acts enacted under the Sixteenth Amendment Congress has, except in cases falling under the provisions relating to the filing of consolidated returns, regarded corporations as taxable entities separate and distinct from their stockholders, and has applied this rule whether the corporate stock was owned by one person or by many.

With the possible exception of two cases,[5] this Court has uniformly applied to tax cases the general rule that a corporation is separate from its stockholders, and thus has carried out the purpose of Congress that the separate identity is to be maintained. *Planters' Cotton Oil Co.* v. *Hopkins, supra; Eisner* v. *Macomber,* 252 U. S. 189; *Peabody* v. *Eisner,* 247 U. S. 347; *Lynch* v. *Hornby,* 247 U. S. 339. Of course it may be said that even if Congress had not indicated its purpose to treat corpo-

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of 1917. Such validation is particularly necessary as the taxation of the largest corporations is determined on the basis of the consolidated return." (Italics ours.)

When the bill reached the Senate section 1331 was substituted for section 1007, and the Committee on Finance, in reporting the bill to the Senate, used substantially the same language as that of the Committee on Ways and Means above quoted. (Senate Report No. 275, to accompany H. R. 8245, 67th Cong., 1st sess., p. 34.) As the bill finally emerged Section 1331 retroactively validated the principal provisions of Articles 77 and 78.

[5] These are *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, and *Gulf Oil Corp.* v. *Lewellyn,* 248 U. S. 71, relied on by the court below and distinguished, *infra,* p. 16 *et seq.*

rations and their stockholders separately for tax purposes the general rule would be applied in tax cases as it is in other cases, in the absence of statutory provision to the contrary.

Not only is the decision of the court below contrary to the purpose of Congress and the decisions of this Court which have been cited, but it is also contrary to the clear weight of authority in the other Federal courts. *The Falk Corporation* v. *Commissioner* (C. C. A. 7th), decided July 6, 1932, reported in Prentice Hall Tax Service, 1932, Vol. I, p. 1972; *Gossett* v. *Commissioner,* decided June 13, 1932, reported in 59 F. (2d) 365 (C. C. A. 4th); *Burnet* v. *Riggs National Bank,* 57 F. (2d) 980 (C. C. A. 4th); *Dalton* v. *Bowers,* 56 F. (2d) 16 (C. C. A. 2d), now pending in this Court on certiorari, No. 52, October Term, 1932; *Athol Manufacturing Co.* v. *Commissioner,* 54 F. (2d) 230 (C. C. A. 1st); *Planters' Cotton Oil Co.* v. *Hopkins,* 53 F. (2d) 825, 827 (C. C. A. 5th), affirmed, 286 U. S. 332; *American Printing Co.* v. *United States,* 53 F. (2d) 98 (D. Mass.); *McDonald* v. *Commissioner,* 52 F. (2d) 920, 922 (C. C. A. 4th); *Darby-Lynde Co.* v. *Commissioner,* 51 F. (2d) 32, 33 (C. C. A. 10th); *Nixon* v. *Lucas,* 42 F. (2d) 833, 834 (C. C. A. 2d); *Wagner* v. *Lucas,* 38 F. (2d) 391, 392 (App. D. C.); *Insurance & Title Guarantee Co.* v. *Commissioner,* 36 F. (2d) 842, 843 (C. C. A. 2d), certiorari denied, 281 U. S. 748; *Goldberg* v. *Commissioner, supra,* 36 F. (2d) 551, 552 (App. D. C.); *Langstaff* v. *Lucas,* 9 F. (2d) 691 (W. D. Ky.),

affirmed, 13 F. (2d) 1022 (C. C. A. 6th), certiorari denied, 273 U. S. 721; *Meischke-Smith* v. *Wardell,* 286 Fed. 785 (C. C. A. 9th), certiorari denied, 263 U. S. 699; *Walker* v. *Gulf & I. Ry. Co. of Texas,* 269 Fed. 885 (C. C. A. 5th).

These decisions all apply the general rule that the separate entity of a corporation is to be recognized in tax cases.

So far as we know the only decisions of lower Federal courts which, like the decision of the court below, seem to be opposed to the weight of authority are *National Slag Co.* v. *Commissioner,* 47 F. (2d) 846 (C. C. A. 3d); *Washburn* v. *Commissioner,* 51 F. (2d) 949 (C. C. A. 8th); and *Clark* v. *Burnet,* decided April 11, 1932, reported in 59 F. (2d) 1031 (App. D. C.). The *National Slag Co.* case was also decided by the court below. It involved the question presented in *Planters' Cotton Oil Co.* v. *Hopkins, supra,* in which the Circuit Court of Appeals refused to follow the decision in the *National Slag Co.* case, and was affirmed by this Court, 286 U. S. 332. Thus the *National Slag Co.* case can no longer be regarded as authority. The *Washburn* and *Clark* cases involved the question presented in *Dalton* v. *Bowers,* now pending in this Court, No. 52, October Term, 1932. The decisions in those cases are contrary to the decision in the *Dalton* case, and we believe that they are erroneous. The Government has filed a petition for certiorari in the *Clark* case, No. 180, October Term, 1932.

The court below seems to have based its decision in part on the view that the taxpayer was an agent of the Widener estate. It is settled that a subsidiary corporation is not the agent of a parent company. *Cannon Manufacturing Co.* v. *Cudahy Packing Co., supra,* 267 U. S. 333, 335, 337; *People's Tobacco Co.* v. *American Tobacco Co., supra,* 246 U. S. 79; *Philadelphia & Reading Ry.* v. *McKibbin,* 243 U. S. 264, 268; *Peterson* v. *Chicago, Rock Island & Pacific Ry., supra,* 205 U. S. 364, 392; *Conley* v. *Mathieson Alkali Works, supra,* 190 U. S. 406, 408, 411–412. There is no more reason to hold that a corporation is the agent of its sole stockholder where the stockholder is not a parent company but an individual or an estate. In any ordinary business transaction it seems clear that it would be incorrect to regard the corporation as agent for its sole stockholder. We believe that the view of the court below, that the corporation was an agent for the stockholder, is really based upon the same view which induced the court below to hold that the corporate entity was to be disregarded, and is equally erroneous.

The court below considered the decisions of this Court in *Southern Pacific Co.* v. *Lowe, supra,* 247 U. S. 330, and *Gulf Oil Corporation* v. *Lewellyn, supra,* 248 U. S. 71, as controlling in principle in the decision of this case. We believe that those decisions are distinguishable and that they are not controlling in the situation presented here.

In *Southern Pacific Co.* v. *Lowe, supra,* the Southern Pacific Company owned all the stock of the Central Pacific Railway Company and operated all of the physical properties of the latter company under a lease. The provisions of the lease were observed by both corporations for bookkeeping purposes. The Southern Pacific Company acted as cashier and banker for both companies. The Central Pacific Company kept no bank account, its earnings being deposited in the bank account of the Southern Pacific Company, the latter company advancing to the former funds as needed. As of March 1, 1913, the Central Pacific Company's books showed a large surplus, principally in the form of a debit against the Southern Pacific Company.

During 1914 the directors of the Central Pacific Company declared dividends out of this surplus, but the payment was carried out by bookkeeping entries only, which simply reduced the apparent indebtedness of the Southern Pacific to the Central Pacific by precisely the amount of the dividends. The Commissioner of Internal Revenue sought to tax such dividends as income accruing in 1914. This Court held that the surplus had accrued to the Southern Pacific Company prior to 1913 and that the declaration and entry of a dividend merely evidenced in form that which in substance had formerly occurred. While the Court said (p. 337)—

> * * * While the two companies were separate legal entities, yet in fact, and for all practical purposes they were merged, the former being but a part of the latter, acting merely as its agent and subject in all things to its proper direction and control—

the decision was expressly limited as follows (p. 338):

> The case turns upon its very peculiar facts, and is distinguishable from others in which the question of the identity of a controlling stockholder with his corporation has been raised.

As limited to the facts before the Court, the decision may be regarded as holding merely that money borrowed by a stockholder from a corporation in which he holds all of the stock may, under the circumstances disclosed in that case, be treated as a dividend and hence as income when the money is received. So viewed, the decision is in harmony with more recent decisions holding that no formal declaration of a dividend is necessary where substantially all the corporate stock is owned by a single stockholder. See *Christopher* v. *Burnet*, 55 F. (2d) 527, 528 (App. D. C.); *Hadley* v. *Commissioner*, 36 F. (2d) 543 (App. D. C.); *Chattanooga Savings Bank* v. *Brewer*, 17 F. (2d) 79 (C. C. A. 6th), certiorari denied, 274 U. S. 751; *Atherton* v. *Beaman*, 264 Fed. 878 (C. C. A. 1st). The principle of those decisions clearly has no bearing upon the question now presented.

The scope of the decision in the *Southern Pacific Company* case was considered by the Circuit Court of Appeals for the Second Circuit in *Nixon* v. *Lucas, supra,* 42 F. (2d) 833. In the *Nixon* case, partners owned all the stock in a corporation and made certain loans to it, for which they were to receive any profits by way of recoupment.

In the tax years in question, the corporation sustained losses which the partners sought to deduct from their income-tax returns, asserting that the company had no actual existence and that the company was really a branch of the partnership business, and that the corporate entity should be disregarded. The taxpayers relied upon *Southern Pacific Co.* v. *Lowe.* The court held that the *Southern Pacific Company* case was not controlling, saying (p. 835):

> Yet we are disposed to regard it as controlling that the relations between the corporations came into being before the passage of the Sixteenth Amendment. The taxpayer had had power to declare the earnings as dividends before there was any tax, and as nothing turned upon the time when it did so, the whole matter being formal in any case, it was safe to assume that its inaction was due to its failure to anticipate the new tax. That gave warrant for ignoring the formal relations between the two. * * *

It seems apparent, therefore, that the decision of this Court in the *Southern Pacific Co.* case should not be regarded as laying down any general rule

authorizing the disregard of corporate entities in tax cases, and that it should be limited to its particular facts.

The exact basis of this Court's decision in *Gulf Oil Corp.* v. *Lewellyn, supra,* 248 U. S. 71, is not readily apparent. There the Gulf Oil Corporation held all the stock of other corporations, all being engaged in the single enterprise of buying, transporting, refining, and selling oil. As stated in the opinion (p. 72):

> The subsidiary companies had retained their earnings, although making some loans *inter se,* and all their funds were invested in properties or actually required to carry on the business, so that the debtor companies had no money available to pay their debts. In January, 1913, the petitioner [parent company] decided to take over the previously accumulated earnings and surplus and did so in that year by votes of the companies that it controlled.

The fact that the earnings had accumulated, and had been used as capital, before March 1, 1913, seems to have been the factor justifying the application of the decision in *Southern Pacific Co.* v. *Lowe.*[6] See *Walker* v. *Gulf & I. Ry. Co. of Texas,*

[6] This is indicated by the fact that the Court thought that its decision in *Lynch* v. *Turrish,* 247 U. S. 221, had some application. It said (248 U. S. 71, 72): "The earnings thus transferred had been accumulated and had been used as capital before the taxing year. *Lynch* v. *Turrish,* 247 U. S. 221, 228."

Lynch v. *Turrish* involved a liquidation and final distribution by a corporation in 1914 of corporate assets which

269 Fed. 885, 890 (C. C. A. 5th); *Meischke-Smith* v. *Wardell*, 286 Fed. 785, 791–792 (C. C. A. 9th), certiorari denied, 263 U. S. 699.

We believe that the *Gulf Oil Corporation* case, like the *Southern Pacific Co.* case, is to be regarded as limited to its particular facts and as not laying down any general rule requiring the disregard of corporate entities in tax cases or as controlling decision here.

The decision of the court below is without support in decisions of this Court. It is clearly contrary to the weight of authority in other Federal courts. It disregards the purpose of Congress to treat corporations and their stockholders separately. We believe that the decision is erroneous and should be reversed.

II

THE DETERMINATION OF GAIN BY THE COMMISSIONER WAS CORRECT

On March 1, 1913, respondent owned 225,000 shares of British-American Tobacco Company stock having a fair market value of $5,315,625 or $23.625 per share. In 1919 through the exercise of rights growing out of such ownership it acquired 75,000 additional shares at a total cost of $326,437.50, or $4.3525 per share. (R. 5, 11.) In 1920 it exchanged the certificates representing the 225,000

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had not increased in value since March 1, 1913, but had increased in value during the corporate tenure prior thereto. It was held that the difference between the cost and the March 1, 1913, value did not accrue as a profit during 1914.

original shares for property having an admitted value of $5,287,500. In determining respondent's gain per share the Commissioner divided the total of the March 1, 1913, value of the 225,000 shares and the cost of the 75,000 shares by the total number of shares, thus determining a cost base per share of $18.806875 (R. 11) and a profit of $1,055,-953.12 instead of a loss of $28,125, as claimed by respondent (R. 3–5).

The Commissioner's action was in accordance with Article 39 of Treasury Regulations 45 (1920 Edition) as amended by T. D. 3402, I–2 C. B. 63 (*supra*, p. 3), construing the provisions of Section 202 of the Revenue Act of 1918 (*supra*, p. 2).[7] Treasury Decision 3402 was promulgated October 18, 1922, following the decision of this Court in *Miles* v. *Safe Deposit Co.*, 259 U. S. 247 (decided May 29, 1922). The regulation as so amended conforms to the rule approved in that decision.

The substance of Treasury Decision 3402 was carried forward into Article 39 of Treasury Regulations 65 and 69[8] and Article 58 of Treasury Regulations 74. The material provisions of Section 202 of the Revenue Act of 1918 have been reenacted in Section 202 of the Revenue Act of 1921 (c. 136, 42

[7] Section 202 directs that in ascertaining the gain derived or the loss sustained from the final disposition of property the basis shall be the March 1, 1913, value if acquired prior thereto, or the cost if acquired subsequently.

[8] Article 39 of Treasury Regulations 69 adopted a slightly different method of computing gain; however, the result under either method is always substantially the same.

Stat. 229), Section 204 of the Revenue Act of 1921 (c. 136, 42 Stat. 231), Section 204 of the Revenue Acts of 1924 (c. 234, 43 Stat. 258; U. S. C., Title 26, Sec. 935) and 1926 (c. 27, 44 Stat. 14; U. S. C. App. V, Title 26, Sec. 935), and Section 113 of the Revenue Acts of 1928 (c. 852, 45 Stat. 818; U. S. C. Sup. V, Title 26, Sec. 2113) and 1932 (Pub. No. 154, 72d Cong.). Reenactment of the statute after such administrative construction imports legislative approval thereof. *Brewster* v. *Gage,* 280 U. S. 327, 337; *McCaughn* v. *Hershey Chocolate Co.,* 283 U. S. 488, 492–493.

In *Ayer* v. *Blair,* 25 F. (2d) 534, the Court of Appeals of the District of Columbia had before it the precise question here presented and upon authority of the decision of this Court in *Miles* v. *Safe Deposit Co., supra,* sustained the action of the Commissioner. As early as 1921 the United States District Court for the Southern District of New York, in *Towne* v. *M'Elligott,* 274 Fed. 960, directed the computation of a tax upon the same basis. These decisions were followed and applied in *Hewes* v. *Eaton,* 39 F. (2d) 917 (Conn.), and so far as we have been able to ascertain there are no decisions to the contrary.

We believe that the Commissioner's computation of the tax, which was approved by the Board of Tax Appeals and was not considered by the court below, was correct, and that upon reversal of the court below the decision of the Board of Tax Appeals should be affirmed.

CONCLUSION

It is respectfully submitted that the decision of the court below should be reversed and the decision of the Board of Tax Appeals should be affirmed.

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